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Plateau Mining Company, a Delaware Corporation, and Cyprus Western Coal Equipment Company, a Delaware Corp. v. The Utah Division of State Lands and Forestry, Ralph Miles, Director of the Division of State Lands and Forestry, the Utah Department of Natural Resources, Dee Hansen, Executive Director of the Utah Department of Natural Resources : Brief of Respondent

Original Brief Submitted to the Utah Supreme Court; digitized by the Howard W. Hunter Law Library, J. Reuben Clark Law School, Brigham Young University, Provo, Utah; machine-generated OCR, may contain errors.
James M. Elegante; Patricia J. Winmill; Lucy B. Jenkins; Kenneth R. Barrett; Parsons, Behle & Latimer; attorneys for respondents.
David L. Wilkinson; attorney general; David S. Christensen; assistant attorney general; Clark B. Allred, Gayle F. McKeahnie; Nielsen & Senior; attorneys for appellants.

IN THE SUPREME COURT OF THE STATE OF UTAH

PLATEAU MINING COMPANY, a Delaware corporation, and CYPRUS WESTERN COAL EQUIPMENT COMPANY, a Delaware corporation,

Plaintiffs/Respondents,

vs.

THE UTAH DIVISION OF STATE LANDS AND FORESTRY, RALPH MILES, DIRECTOR OF THE DIVISION OF STATE LANDS AND FORESTRY, THE UTAH BOARD OF STATE LANDS AND FORESTRY, THE UTAH DEPARTMENT OF NATURAL RESOURCES, DEE HANSEN, EXECUTIVE DIRECTOR OF THE UTAH DEPARTMENT OF NATURAL RESOURCES,

Defendants/Appellants.

Case No. 880120

BRIEF OF RESPONDENTS

Appeal from the Seventh Judicial District Court of Carbon County, State of Utah
The Honorable Boyd Bunnell, Judge.

DAVID L. WILKINSON
UTAH STATE ATTORNEY GENERAL
DAVID S. CHRISTENSEN
ASSISTANT ATTORNEY GENERAL
124 State Capitol
Salt Lake City, Utah 84114

CLARK B. ALLRED
GAYLE F. McKEACHNIE
NIELSEN & SENIOR
Special Assistant Attorney General
363 East Main Street
Vernal, Utah 84078
Attorneys for Defendants/Appellants

JAMES M. ELEGANTE
PATRICIA J. WINMILL
LUCY B. JENKINS
KENNETH R. BARRETT
PARSONS, BEHLE & LATIMER
185 South State Street
Suite 700
P.O. Box 11898
Salt Lake City, Utah 84147
Attorneys for Plaintiffs/Respondents

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PARSONS, BEHLE & LATIMER
185 South State Street
Suite 700
P.O. Box 11898
Salt Lake City, Utah 84147
Attorneys for Plaintiffs/Respondents

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The defendants (collectively the "State" unless otherwise indicated) issued an audit of State Coal Lease No. 22729 (the "State Lease") to the plaintiffs (collectively "Plateau" unless otherwise indicated) and demanded payment of alleged unpaid royalties. Plateau filed a complaint for declaratory judgment against the State challenging the audit. This appeal is brought by the State from the District Court's Memorandum Decision and Declaratory Judgment granting summary judgment for Plateau. The Supreme Court of the State of Utah has jurisdiction to hear this appeal under Utah Code sections 78-2-2(3)(e)(iii) and 78-2-2(3)(j).

STATEMENT OF ISSUES

The issues presented for review on this appeal are as follows:[1]

1. Whether the District Court properly:

(a) found the royalty provision in the State Lease to be ambiguous;

(b) construed the royalty provision in light of the parties' course of conduct, which interpreted the royalty rate to be $0.15 per ton;

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1 In accord with Rule 24(b) of the Rules of the Utah Supreme Court, Plateau includes its own statement of issues because it is dissatisfied with the State's distorted and argumentative statement of issues.

(c) found the royalty provision was not self-executing;

(d) applied the doctrine of equitable estoppel against the State;

(e) found that the State may not retroactively apply its new policy imposing a royalty rate of 8%;

(f) found that the State's new royalty policy is a rule which is invalid because of the State's failure to follow the provisions of the Utah Administrative Rulemaking Act;

(g) found that the State waived its right to demand payment of royalties on coal mined during the Audit Period at any rate higher than $0.15 per ton;

(h) found that the State is not entitled to interest on any royalty payment deficiencies;

(i) found that the State is not entitled to penalties for any royalty payment deficiencies; and

(j) found that the prevailing federal royalty rate during the Audit Period was not 8%.

STATEMENT OF THE CASE[2]

This lawsuit centers on the State's claim against Plateau for royalties alleged to be due under the State Lease for the period of April 1, 1979 to December 31, 1984 (the "Audit Period"). The State Lease, entered into on March 15, 1965, provides that a royalty is to be paid to the State of Utah at the rate of $0.15 per ton or the rate prevailing for federal land of similar character under coal leases, whichever is higher (R. 144-45).[3] The State Lease was originally applied for and approved by the Board of State Lands and Forestry (the "Board") at a royalty rate of $0.15 per ton (R. 144, 368-69, 499).

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2 The State's Statement of the Case, and its entire Brief, is riddled with assertions of fact without references to the Record, as required by Rules of the Utah Supreme Court, Rule 24(a)(7), and which are in fact unsupported by the Record. Appendix "A" is a list of such unsupported assertions. The Court has held that if the appellant fails to provide adequate citations to the record, the judgment of the lower court is presumed to be correct. Fackrell v. Fackrell, 740 P.2d 1318, 1319 (Utah 1987).

3 Article III, Paragraph 2 of the State Lease provides that a production royalty would be paid:

> (a) at the rate of 15¢ per ton of 2000 lbs. of coal produced from the leased premises and sold or otherwise disposed of, or
>
> (b) at the rate prevailing, at the beginning of the quarter for which payment is being made, for federal lessees of land of similar character under coal leases issued by the United States at that time,
>
> whichever is higher. . . .

Plateau and its predecessors mined under the State Lease on a regular basis from the date the lease was entered into until December, 1984 (R. 146, 369, 499). At all times when mining was conducted under the State Lease, and during the entire Audit Period, Plateau paid royalties, and the State accepted royalties, at the rate of $0.15 per ton (R. 146, 369, 500). This rate was clearly reflected in each royalty statement submitted by Plateau and its predecessors with each payment before and during the Audit Period (R. 146). The State accepted the royalty payments and royalty statements each quarter without objection (R. 146-47, 369, 500). The lower court found that this long-standing and unvarying course of conduct over a span of nearly twenty years established a $0.15 per ton royalty rate for the Audit Period (R. 677).

In 1980, during the Audit Period, the State represented to Plateau that the State Lease was in good standing, but for the failure to pay 1980 rentals (R. 147, 369-70, 500). In 1985, before plaintiff Cyprus Western Coal Equipment Company ("Cyprus") acquired Plateau, it reviewed the file maintained by the State on the State Lease and questioned State personnel about the status of the State Lease (R. 148). Nothing in the file indicated that Plateau had underpaid the royalty due under the State Lease (R. 148, 370, 500). The State personnel represented to Cyprus that the State Lease was in good standing (R. 148).

In an October 15, 1985 letter to Plateau, the State announced a new policy relating to coal royalties. In those letters, the State asserted that under subparagraph (b) of the royalty provision (the "prevailing federal rate clause"), royalties for the Audit Period were due at the rate of 8% of the value of coal mined. According to the State, under the Federal Coal Lease Amendments Act of 1976 ("FCLAA"), and the regulations promulgated thereunder, the prevailing rate during the Audit Period for all underground federal coal mining operations was 8% of the coal value.[4] (R. 149). The State demanded payment of

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4 The contention that federal law requires an 8% royalty rate for all underground federal coal leases is based upon a misreading of the regulation upon which the State relies. That regulation provides:

> A lease shall require payment of a royalty rate of not less than 8 percentum of the value of the coal removed from an underground mine, except that the authorized officer may determine a lesser amount, but in no case less than 5 percent if conditions warrant.

43 C.F.R. § 3473.3-2(a)(3) (1986). This regulation does not, as the State contends, provide for an 8% royalty rate on all underground federal coal leases. Rather, it requires the Department of the Interior to consider whether a rate of between 5% and 8% should be imposed. The Tenth Circuit Court of Appeals has recently ruled that this is the clear meaning of the regulation in Coastal States Energy Co. v. Hodel, 816 F.2d 502 (10th Cir. 1987). In that case, the court considered the Department of Interior's assertion that upon the 20-year readjustment of federal coal leases, the provisions of the regulation require the imposition of an 8% rate. The court rejected this assertion out of hand and ruled that the regulation does not "automatically fix" a royalty rate of 8% for all under-

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$1,916,909.27 for alleged royalty underpayment, $1,058,545.32 for accrued interest, $16,158.85 as a penalty, and additional accrued interest (R. 149, 240).

The District Court granted Plateau's Motion for Partial Summary Judgment[5] on the issue of liability for the alleged deficiency and denied the State's Motion for Partial Summary Judgment (R. 680). The State filed this appeal.

SUMMARY OF ARGUMENT

Each argument numbered 1 through 6 below is made in the alternative because each provides an independent basis for upholding the District Court's decision.

1. The prevailing federal rate clause is ambiguous on its face because it is susceptible to numerous possible interpretations. The parties' course of performance indicates that they chose not to attempt to apply this ambiguous provision and to

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ground coal leases, but rather the Department is required to consider royalty rates in the range of 5% to 8%. Id. at 507. Thus, even if the State could apply its new royalty policy retroactively, that policy would be invalid because it is based upon a misunderstanding of the federal law regarding underground royalty rates.

[5] Plateau's Motion was partial because it did not include subparagraphs 36(h) and (i) of its Complaint relating to the determination of the value of coal (R. 11). These issues are moot if the Court upholds the lower court's decision.

relied instead on subparagraph (a) of the royalty provision, which provides for a royalty of $0.15 per ton.

2. The prevailing federal rate clause is not self-executing. Plateau had no duty to pay royalties under the prevailing federal rate clause unless and until there was an agreement between the State and Plateau as to the applicable royalty under that provision.

3. The State is estopped from attempting to retroactively invoke the prevailing federal rate clause. In electing to mine coal from the State Lease, Plateau relied on the State's acceptance of $0.15 per ton without objection and the State representations that the State Lease was in good standing. Cyprus relied on the State's representations of good standing when it acquired Plateau in 1985. If the State is allowed to repudiate its long-standing practice and retroactively apply the prevailing federal rate clause, Plateau will suffer great financial injury. Any loss to the school trust fund that may result from estopping the State does not constitute a substantial adverse effect on public policy that would outweigh the injury to Plateau if the State is not estopped.

4. The State's newly formed interpretation of the prevailing federal rate clause amounts to a policy that the State has attempted to apply retroactively in contravention to the well established rule that, when prior agency policies have been

relied upon, new policies will not be applied retroactively to the detriment of the relying parties.

5. Because it has general applicability, the State's new royalty policy is a rule which, absent compliance with the Utah Administrative Rulemaking Act, is invalid and may not be applied prospectively, much less retrospectively.

6. Because the State was aware of the prevailing federal rate clause but failed to invoke it in a timely manner, the State voluntarily relinquished and consequently waived its right to demand royalty payments at a rate higher than $0.15 per ton.

7. The State's attempt to apply its interest and penalty rules, which were promulgated after the parties entered into the State Lease, is contrary to the express terms of the lease and therefore invalid.

8. The State is not entitled to summary judgment that 8% of gross sales value is the applicable royalty under the prevailing federal rate clause during the Audit Period because there are issues of material fact that must be resolved before such a determination can be made. If this Court holds against Plateau on arguments 1-6 above, a trial would be necessary to determine the applicable royalty rate under the prevailing federal rate clause.

ARGUMENT

I. AN ARBITRARY AND CAPRICIOUS STANDARD OF REVIEW IS INAPPLICABLE IN THIS CASE.

In the section of its Brief entitled "Standard of Review," the State asserts that the issues before this Court were decided against Plateau by the Director of the Division of State Lands and Forestry (the "Director" and the "Division"), and that the Director's decision should not be overturned unless it is found to be arbitrary or capricious. This argument is based on erroneous factual and legal premises and was not accepted by the District Court.

Following the issuance of the Audit Report and demand for payment, Plateau sent a protest letter to the Director in January of 1986 (R. 497-98). On March 4, 1986, the Director responded in a one-page letter summarily rejecting Plateau's argument (R. 498). There was no hearing; no legal memoranda, affidavits or exhibits were received. The decision was based solely on the Audit Report and Plateau's protest letter, and the Director merely reaffirmed the position he had previously taken in the Audit Report. The Utah Supreme Court has ruled that where, as here, there is no record for the court to review, other than plaintiffs' protest and the agency's decision, and a complete airing of the issues and facts was not had before the agency, the court must conduct an independent inquiry and may not simply defer to the agency's naked decision. Denver & Rio Grande

Western Railroad Co. v. Central Weber Sewer Improvement Dist., 4 Utah 2d 105, 287 P.2d 884, 887 (1955).

Moreover, this case involves issues of contract construction and statutory interpretation and the application of equitable principles, areas in which courts do not accord agencies any deference. Because these issues are wholly outside the Director's expertise, the Court must make its own "independent determination of the correct application of the governing principles." Texas Gas Transmission Corp. v. Shell Oil Co., 363 U.S. 263, 270 (1960); see also Adkins v. Division of State Lands, 719 P.2d 524, 526 (Utah 1986) (on questions of statutory construction involving pure questions of law, no deference is accorded agency determination). The Director's decision turned on issues as to which the Division has no expertise, was based on the most superficial of inquiries, and was made by an interested party, rather than an impartial decisionmaker. Accordingly, it is not entitled to deference from this Court.

Aside from the matter discussed above, Plateau agrees with the State that the Court need not defer to the District Court in deciding the issues of law presented in this case.

II. THE DISTRICT COURT PROPERLY FOUND THAT PLATEAU WAS ENTITLED TO SUMMARY JUDGMENT BASED ON THE UNDISPUTED FACTS AND THE LAW.

A. The District Court Properly Found the Royalty Provision to be Ambiguous.

The State asserts that the District Court held that the royalty provision is ambiguous "because the escalator clause required plaintiffs to determine the prevailing rate from facts outside the lease". Appellants' Brief at 19. This is a gross misstatement of the District Court's Memorandum Decision. The District Court found the royalty provision to be ambiguous because it is susceptible of several different interpretations.[6] The case law supports this conclusion that the royalty provision of the State Lease is ambiguous as a matter of law because it is susceptible of many varying and inconsistent interpretations. See Russell v. Valentine, 14 Utah 2d 26, 376 P.2d 548 (1962); Crestview Bowl, Inc. v. Womer Construction Co., Inc., 225 Kan. 335, 592 P.2d 74 (1979).

Several phrases of the prevailing federal rate clause of the royalty provision are ambiguous. One is the term

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[6] "Part (b) leaves the amount due based on several factors not immediately capable of definitive determination. The ambiguity arises as much from what is not stated and provided as from what is stated. In other words, at the beginning of the reporting quarter what is the prevailing federal rate and who makes that determination, the lessor or the lessee, and what factors are to be included in making a determination as what federal rate prevails and in what area is it prevalent? Who makes the determination that the land in the State Lease and the land in the Federal Lease are similar in character and what is the basis for determining similarity? What time period is used to determine federal leases "issued . . . at that time" and who makes that determination? Even if a prevailing federal rate is established, does it apply to the "value of the coal removed" as stated in the federal regulation or to the "gross sales value" as used by the State auditor in his assessment, and who makes that determination?" (R. 676); see also Appendix "B" attached hereto.

requiring royalty payments on the State Lease to be matched to royalty payments on federal "land of a similar character." "Similar character" may mean land with the same quality of coal, land with the same geologic formation, or land where the costs of mining and transportation are similar. It also is unclear to which geographical area the clause refers. For example, the clause could refer to federal coal leases issued in the same drainage, the same county, the same state, the same region or across the nation. Nor is it clear what is meant by "coal leases issued by the United States at that time." Use of the phrase "at that time" creates uncertainty. Does this mean newly issued leases or all leases in effect during the reporting quarter? Does it refer only to producing leases? Finally, it is not clear what is meant by "rate prevailing." "Prevailing" is defined by Webster's Third New International Dictionary (1971) as:

> 1: having superior force or influence: Efficacious (the - doctrine of wind) 2a: most frequent (windows facing the - wind) b: generally current: common (adapted a loose structure of - ideas to the needs of his own temperament --M.D. Geismar).

In the context of the prevailing federal rate clause, prevailing appears to mean the most frequent or common federal royalty rate.[7] Even the use of this definition creates an ambiguity.

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7 This also appears to be the State's interpretation of "prevailing." They have asserted 8% to be the "prevailing" rate,

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What does the most frequent or common rate mean? More than fifty percent? What if the breakdown for lease rates was 33 1/3% at \$0.15 per ton, 33 1/3% at \$0.175 per ton and 33 1/3% at 8%? Was it the lessee's duty to obtain current lease rates from BLM each quarter? What geographical area was to be considered? Some of the numerous possible interpretations of the various terms in the prevailing federal rate clause are listed in the chart attached hereto as Appendix "B". When the various interpretations of the key phrases in the clause are combined, there are at least <u>972</u> distinct interpretations of the clause as a whole.[8]

The underground royalty rates for federal coal leases in Utah that were in effect during the Audit Period varied from \$0.10 per ton to 12.50% of value (R. 496). Federal coal leases during the same time period across the nation had the same range of royalty rates (R. 496). In order to determine the most common federal coal lease royalty rate, Plateau would have had to survey

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because they try to achieve some arithmetical majority by asserting that the royalty rate in 19 of 24 <u>newly issued</u> federal coal leases during the Audit Period is 8%. <u>See</u> Appellants' Brief at 20.

8 As set forth in Appendix "B", there are four phrases in the clause that are each susceptible of numerous interpretations. Using mathematics, the number of interpretations of the entire clause is equivalent to the number of combinations of the different interpretations of each phrase, which is 972 distinct combinations.

all currently issued federal coal leases either at the Utah State Office or the Washington office of BLM, and survey these leases at least quarterly (and there were over 200 federal coal leases in Utah in effect during the Audit Period (R. 496-97)). However, even if Plateau had gathered this information, it would have been impossible for Plateau to determine the prevailing rate because of the ambiguities in the prevailing federal rate clause. Even if Plateau had considered only the federal coal leases in Utah that it held or ones in which it had an ownership interest, the royalty rates ranged from $0.15 per ton to 8% (R. 496).

Because of these numerous ambiguities, the royalty provision does not have a plain meaning as the State asserts. Furthermore, if the provision has only one meaning and is so straightforward, why is it that none of the owners of the other five producing state coal leases with similar royalty clauses interpreted the provision according to the State's reading (R. 153, 156, 372-73, 502-03)?[9] Plateau submits that even if it had unilaterally attempted to apply the clause during the Audit Period, it nonetheless would be in court today because the State

9 Three other cases involving the same royalty provision and similar facts have been filed against the State, decided in favor of the lessee by the District Court and appealed to the Court by the State: Blackhawk Coal Company v. The Utah Division of State Lands and Forestry, Utah Supreme Court, Case No. 880215; Consolidation Coal Company v. The Utah Division of State Lands and Forestry, Utah Supreme Court, Case No. 880243; Trail Mountain Coal Company v. The Utah Division of State Lands and Forestry, Utah Supreme Court, Case No. 880300.

at that time had no idea what the clause meant (R. 154-55, 373, 503) and today with hindsight would probably not agree with such action.[10]

The State asserts that the prevailing rate clause is an escalator clause or "favored nation" clause and that escalator clauses are not ambiguous "if there is a formula or method to set the price." See Appellants' Brief at 19. However, the State ignores the fact that there is not an objective formula or method to set the prevailing royalty because the prevailing federal rate clause is susceptible of so many different interpretations. The cases cited by the State for the proposition that courts uphold favored nation clauses involve clauses that are unambiguous. See Energy Reserves Group, Inc. v. Kansas Power and Light Co., 459 U.S. 400 (1983); Amoco Production Company v. Stauffer Chemical Co. of Wyoming, 612 P.2d 463 (Wyo. 1980); Lonestar Gas Co. v. The Howard Corp., 556 S.W.2d 372 (Tex. 1977).

The State's own officers and employees have acknowledged that the royalty provision is ambiguous.[11] In addition, the Division has demonstrated that the royalty provision is

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10 Consolidation Coal Company is presently involved in a similar lawsuit with the State even though it reached an agreement in 1981 that the prevailing federal rate was $0.175 per ton. (R. 156). See supra, fn.9.

11 The following officers and employees of the Division acknowledged during discovery in Trail Mountain Coal Company v.

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ambiguous by itself adopting different interpretations. Prior to 1985, the Division interpreted the prevailing federal rate clause to include only those federal leases that were producing in the same area. The Division was not sure of the meaning of "same area" but would have recommended to the Board that it mean a "particular drainage area" (R. 154-55). In contrast, the State now interprets the royalty provision in this case to have another meaning: the State now views the royalty rate to be 8%, relying in part on all federal leases which have been issued or adjusted within the State of Utah since January 1979, regardless of whether such leases are in production.

The royalty provision mystified other agencies of the state. In 1977, the Legislative Auditor General requested an opinion from the Office of Legislative General Counsel on the meaning of "land of a similar character" within the context of the royalty provision (R. 151-52, 372, 502). The resulting Legislative General Counsel Opinion dated April 8, 1977 concluded

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<u>The Utah Division of State Lands and Forestry</u>, District Court Case No. 4847, a case involving a state coal lease containing an identical royalty provision (R. 153), that the royalty provision is ambiguous: Ralph A. Miles, Director of the Division; Donald G. Prince, Assistant Director of the Division; and John Thomas Blake, Mineral Resources Specialist with the Division (R. 621-24). The Division itself admitted that Mr. Miles "is or was of the opinion that the royalty provision . . . is ambiguous" (R. 624).

that "[l]and of similar character is sufficiently vague to defy definition" with the following analysis:

> As used in Article III, SECOND, (c), of the attached lease, the term "land of similar character" is so vague as to defy reasonable definition. Initially the problem becomes one of kind, i.e. similar in what regard -- size, productivity, value. Assuming arguendo, that similarity can be established, the second problem arises when it is attempted to establish the magnitude of the lands available for comparison i.e. does the land have to be similar to land in the same county, state, region or is the entire United States available for comparative similarities.
>
> Without further explanation in the lease itself or without knowing the intent of the parties, any definition given herein would be totally inconclusive. Thus, since the term "land of similar character" could be interpreted to have several different meanings, it is ambiguous.

(R. 152, 372, 502). In short, the Opinion concluded that the phrase "land of a similar character" is ambiguous because it has numerous meanings.

It is patently obvious that the prevailing federal rate clause is capable of numerous meanings and interpretations. Thus, the royalty provision is ambiguous as a matter of law.

B. The District Court Did Not Rewrite the Lease; It Properly Construed the Royalty Provision in Light of the Parties' Course of Performance Interpreting the Royalty Rate to be $0.15 Per Ton.

The State contends that the royalty provision clearly provides that the applicable federal royalty rate during the Audit Period was 8% and that the District Court thus erred in construing the royalty provision according to the parties' course of conduct. The State presents general rules of contract construction in support of its interpretation. See Appellants' Brief at 22. Many of the State's cases do not stand for the rule of construction for which they are cited.[12] Further, the State totally ignores the rule of construction that the courts look to the interpretation of the parties by their course of conduct to construe ambiguous contracts (the rule of practical construction). Zeese v. Estate of Siegel, 534 P.2d 85 (Utah 1975); Ackerman v. Sterling Paving Co., 497 P.2d 699 (Colo. App. 1972); see Bethlehem Steel Corp. v. Shonk Land Co., 169 W. Va. 310, 288 S.E.2d 139 (1982).

In Ackerman, the lessor brought an action to recover an alleged deficiency in royalties under a sand and gravel lease. The Colorado Court of Appeals concluded that the lease was ambiguous as to the amount of royalties and held that the

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12 Utah Valley Bank v. Tanner, 636 P.2d 1060, 1061 (Utah 1981), does not hold that "the intent of the parties when entering into the contract controls the meaning of the contract." Appellants' Brief at 22. Nagle v. Club Fontainbleu, 17 Utah 2d 125, 405 P.2d 346, 348 (1965), holds that "[w]here the intent and purpose can be ascertained, it should be enforced in accordance with its substance." Hal Taylor Associates v. UnionAmerica, Inc., 657 P.2d 743, 749 (Utah 1982), holds that "[t]his Court will not rewrite a contract to supply terms which the parties omitted," and that "the first source of inquiry must be the document itself, considered in its entirety." The holding in Public Service Co. v. City and County of Denver, 153 Colo. 396, 387 P.2d 33, 36 (1963), that a contract must be construed liberally to protect the public interest, is limited to public utility franchise agreements.

lessor's continued acceptance of royalty payments under the lessee's interpretation of the lease was dispositive. 479 P.2d at 700-01. The reviewing court found that the evidence supported the trial court's finding:

> That the parties by their conduct before the dispute arose, have interpreted the lease in accordance with [lessee's] construction of its meaning and that the plaintiffs for over three years, at least since the receiving of the summary schedule, . . . have adopted defendant's construction of the lease and acquiesced in such construction . . . ; that [lessor's] . . . took no sufficient or positive action to establish their now asserted construction of the lease.

Id. at 700.

In accord with Ackerman is Bethlehem Steel Corp. v. Shonk Land Co., 169 W. Va. 310, 288 S.E.2d 139 (1982). There the lessor, after ten years of accepting royalty payments under the lessee's interpretation of a coal lease, brought an action to recover alleged deficiencies, arguing that the lessee had incorrectly interpreted the lease. The court upheld the lessee's construction, stating:

> Our interpretation that royalty payments were to be made on railroad weights and not run-of-mine coal . . . is consistent with [the lessee's] conduct. [The lessor's] ten year failure to object to those royalty calculations reinforces our reversal of the trial court's determination that royalties were due on the run-of-mine coal.

Id. at 146 (footnote omitted); see also Kretni Development Co. v. Consolidated Oil Corp., 74 F.2d 497 (10th Cir. 1934) (party who received royalty payments on oil and gas lease based on royalty rate of 7-1/2% for almost eight years held bound to parties' course of conduct in interpreting royalty provision); cert. denied, 295 U.S. 750; Champlin Petroleum Co. v. Ingram, 560 F.2d 994, 998 (10th Cir. 1977) (parties' construction of ambiguous oil and gas lease royalty provision for 30 years upheld where both parties had knowledge of the construction), cert. denied, 436 U.S. 958 (1978).

The parties' course of performance indicates that, because of the ambiguity of the prevailing federal rate clause, the parties did not attempt to apply this ambiguous clause but chose to base payments on the rate of $0.15 per ton. Contrary to the State's position, the District Court did not rewrite the contract; it simply followed the parties' course of conduct.[13]

The State also asserts that the parties' course of conduct is not an interpretation of the clause, but a modification of the clause. See Appellants' Brief at 25. Regardless of

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13 The State contends that the District Court's basing a ruling on the parties' course of dealing was tantamount to rewriting the Lease and that the Lease cannot be rewritten without approval of the Director, the Board or the Attorney General. The statutes cited by the State do not in any way indicate that the Director, the Board or the Attorney General have exclusive authority to speak for the Division. Under section 65-1-1 of the Utah Code, the Board is granted policy making authority over state lands. The authority to administer state leases is vested in the Division. Applying the royalty provision of a mineral lease is an administrative function. Further, the Director cannot personally administer all of the State's mineral leases. This function was, in effect, delegated to the Director's staff.

whether the parties' conduct is termed an interpretation or a modification, case law supports the proposition that the parties' course of conduct governs the construction of a contract. Webster's Red Seal Publications, Inc. v. Gilberton World-Wide Publications, Inc., 67 A.D.2d 339, 415 N.Y.S.2d 229 (1979), aff'd, 53 N.Y.2d 643, 438 N.Y.S.2d 998, 421 N.E.2d 118 (1981). In this case Webster sold its magazine publishing rights to Gilberton in 1962. The 1962 sales agreement required Gilberton to pay Webster $1000 per issue for five years plus $0.05 per copy for all copies in excess of 70,000 copies sold of each issue. In 1963 the parties modified the 1962 agreement by letter agreement to reduce the payments, except that if the cover price increased above $0.35 per copy, the original payment terms in the 1962 agreement would be reinstated (the "price proviso"). In 1970, the cover price exceeded $0.35 per copy, but until 1974 Gilberton continued to pay and Webster continued to accept payments at the post-1963 agreement rates. Webster brought suit to recover additional payments due under the 1962 agreement. The court viewed the agreements to be ambiguous and denied Webster's claims based on the rule of practical construction. The court interpreted the contract according to the parties' course of conduct of ignoring the price provision, which the court viewed as a modification implied in fact. Id. at 230. In the present case, the course of conduct of the State and Plateau establishes as a matter of law that the parties interpreted the royalty provision of the State Lease to mean that the royalty rate was $0.15 per ton.[14]

The State's assertion that the intent of the royalty rate provision was to insure receipt of market value and the highest royalty rate paid on federal coal leases is not supported by the Record. See Appellants' Brief at 19, 23 and 24.[15] Furthermore, even if proved to be the parties' original intent, the parties' course of performance is contrary to this intent and should be enforced by the Court. As stated by the Utah Supreme Court, the "rule of practical construction is predicated on the common sense concept that 'actions speak louder than words.'" Bullough v. Sims, 16 Utah 2d 304, 400 P.2d 20, 23 (1972) (quoting Crestview Cemetary Ass'n v. Dieden, 356 P.2d 171 (Cal. 1960)).

Even if the Court were to view the royalty provision to be clear on its face, the contract should be interpreted according to the parties' course of performance where such course of performance is contrary to the wording of the contract. Eie v.

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14 The State asserts, without a reference to the Record, that because Plateau does not argue $0.15 is the prevailing federal rate, it concedes that the federal rate is higher than the royalty rate paid prior to 1976. See Appellants' Brief at 21 and 24-25. This assertion is pure supposition and is not supported by the Record. Plateau does not concede that the prevailing federal rate, whatever that may mean, was higher than $0.15 per ton.

15 The State does not reference the Record to support its assertion. Nor does the State reference the Record to support its assertion that the federal royalty rate was $0.15 per ton on the date of the State Lease. See Appellants' Brief at 19 and R. 360, 495.

St. Benedict's Hospital, 638 P.2d 1190 (Utah 1981); Bullfrog Marina, Inc. v. Lentz, 28 Utah 2d 261, 501 P.2d 266 (1972); Bullough v. Simms, 400 P.2d at 23. This rule is based on the reasoning that the course of performance creates the ambiguity and that a court should not enforce the wording of the contract when the parties have demonstrated that they intended the contract to have a different meaning.

In this case, Plateau and its predecessors paid royalties at the rate of $0.15 per ton, a rate which was clearly reflected on the coal production and settlement transmittals submitted during the Audit Period. The State accepted each payment without objection. By these actions of Plateau and the acquiescence of the State, the royalty clause as a matter of law required the royalty to be paid at the rate of $0.15 per ton.

C. The District Court Properly Found The Royalty Provision Not To Be Self-Executing.

The State views the prevailing federal rate provision to be self-executing. In other words, the State believes that Plateau's duty to pay the "prevailing federal rate," whatever that may mean, arose as soon as that rate exceeded $0.15 per ton, without any action whatsoever by the State. However, the prevailing federal rate clause could not possibly be self-executing when its meaning is not clear on its face. In order to be self-executing, the prevailing rate would have to be an identifiable fact which could be independently ascertained by either party. The prevailing federal rate clause is not tied to an identifiable fact or objective market standard. Thus, the prevailing federal rate clause is nothing more than an open price provision under which the royalty rate could only be established upon agreement, or if not by agreement, then through appropriate policy-making or rule-making procedures as discussed <u>infra</u> at pages 62-64.

Not only does the language of the prevailing federal rate clause dictate that it is not self-executing, the facts indicate that the parties did not intend the provision to be self-executing. The Application for the State Lease and Board Minutes approving the Application and the issuance of the State Lease at the royalty rate of $0.15 per ton indicate that it was the intent of the parties that the royalty rate be $0.15 per ton until the parties agreed to a higher prevailing federal rate or until the State gave Plateau notice and made a fact determination of the prevailing federal rate. Furthermore, the letter dated February 4, 1985 from the State to Plateau, which outlines the terms of readjustment of the State Lease, specifies that the "production royalty rate <u>becomes 8%</u> of gross value of the ore" (emphasis added) (R. 152, 372, 502). The use of the word "becomes" indicates that the rate was not 8% until the readjustment was effective.

This interpretation that the royalty provision is not self-executing is consistent with the State's interpretations of other state coal leases that contain similar royalty provisions (R. 153). By letter dated February 15, 1980 to the lessee, the State explicitly stated that the royalty provision of the Beaver Creek State Lease requires a payment of " . . . 15 cents per ton of 2,000 lbs. of coal produced . . ." (ellipsis signals in original) (R. 153-54, 373, 503). The failure to mention the prevailing federal rate clause of the royalty provision indicates that the State viewed the prevailing federal rate clause to be inapplicable until the State or the parties took action to invoke the clause.

By letter dated October 4, 1976, the State advised the predecessor of Trail Mountain Coal Company that it was the State's policy that the royalty rate payable under the royalty provision was $0.15 per ton until:

> one of two situations which could alter this rate occur. First Part (b) provides that the royalty <u>can be changed to the rate payable under Federal leases in the same area. This change would be made</u> at such time as the Federal lease in question begins production.

(R. 154, 373, 503) (emphasis added). In other words, under the State's view espoused in 1976, the rate does not change from $0.15 per ton until the State takes action to change it or until the parties agree to change it, once there is production on a federal lease in the same area.

The second situation stated in the October 4, 1976 letter under which the rate can be changed arises when the lease is readjusted at the end of each twenty-year period of the lease term. The letter goes on to say:

> Under the provision [governing readjustment], the lease terms including the royalty rate, will be reviewed as of December 31, 1985, and I am sure the rate will be changed to the royalty rate in use at that time.

Thus, it was the intent of the State not to adjust the $0.15 per ton royalty rate under the royalty provision until the lease came up for readjustment.

In 1982, Blackhawk Coal Company notified the State that royalty payments under the Blackhawk State Lease would continue to be based on the $0.15 per ton rate "since the provisions of Article III(b) of this Agreement are inapplicable at the present time" (R. 155, 373, 503). Blackhawk paid, and the State accepted without objection, royalty payments at the rate of $0.15 per ton (R. 155-56, 373, 503). The State's acceptance of and failure to object to the royalty rate or the 1982 letter indicates that the State agreed that the royalty rate was $0.15 per ton until there was a determination or agreement to the contrary.

The language of the prevailing federal rate clause and the conduct of the parties show that the clause was not applicable absent an agreement or alternatively notice and a proper fact determination by the State. There was no agreement, no notice and no proper and timely fact determination by the State. Thus, the only applicable royalty provision in the State Lease was subparagraph (a), requiring a royalty of $0.15 per ton. Because

Plateau paid $0.15 per ton, it complied with the clear terms of the State Lease and owes no additional royalties to the State.

D. The District Court Properly Applied Estoppel Against the State.

1. The Doctrine of Equitable Estoppel Applies Against the State.

In its most recent opinions discussing the applicability of estoppel to the State, the Court has left no doubt that the State may be estopped under appropriate circumstances. In Celebrity Club, Inc. v. Utah Liquor Control Comm'n, 602 P.2d 689 (Utah 1979), the Court stated that equitable estoppel would apply against the State, but that greater caution must be applied when the State is acting in its governmental as opposed to proprietary capacity. Id. at 694 (quoting Metropolitan Park Dist. v. State Dept. of Natural Resources, 85 Wash. 2d 821, 539 P.2d 854 (1975)). Equitable estoppel may be applied against the State, even when it is acting in a governmental capacity "if necessary to prevent manifest injustice, and the exercise of governmental powers will not be impaired as a result." Id. (quoting West v. Dept. of Social and Health Servs., 21 Wash. App. 577, 586 P.2d 516, 518 (1978).

In Utah State Univ. v. Sutro & Co., 646 P.2d 715 (Utah 1982), the Court stated that, as a general rule, estoppel should not be applied against the State. But when it is "plainly apparent" that the application of this rule would result in injustice, and there would be "no substantial adverse effect on public policy," the doctrine applies against the State. Id. at 718. The opinion also points out that courts are increasingly applying estoppel against state agencies, consistent with the trend toward holding government and its agencies more responsible for their actions. Id. at 718 n.4.

Recognizing that there is some variation in the approaches taken by the Court in these cases, Plateau will address the estoppel issue as follows: First, Plateau will establish that the State acted in a proprietary or business capacity when entering into the State Lease; second, Plateau will set forth the elements of estoppel as it would apply to a private party and show that each element is satisfied under the undisputed facts of this case; third, Plateau will show that it will suffer manifest injustice if the State is not estopped; last, Plateau will show that estopping the State will not impair the exercise of governmental powers or have a substantial adverse effect on public policy. This last section will focus on the State's erroneous argument that it cannot be estopped in this case because to do so would violate the State's trust responsibilities for administering school lands.

2. The State Acts in a Proprietary Capacity When Leasing State Lands.

Plateau first focuses on the capacity of the State because if the Court holds that the State acted in a proprietary capacity, the standard for estoppel is less stringent and only the basic elements of estoppel need be satisfied. In Metropolitan Park, cited as authority by the Court in Celebrity Club, 602 P.2d at 694, the Washington Supreme Court stated:

> It must be remembered that when the State functions in its proprietary capacity, it will receive no better treatment than any two private individuals who bring their dispute before the courts for final resolution.

539 P.2d 859. However, even if the Court views the State as acting in a governmental capacity, the two additional elements of manifest injustice and no substantial adverse effect on public policy are clearly satisfied in this case.

Contrary to the State's assertion, this Court has never held that the State administers leases of public lands to private entities in a governmental capacity. On the contrary, the Court's only decision on this subject leads to the opposite conclusion. In Morgan v. Board of State Lands, 549 P.2d 695 (Utah 1976), the Court recognized that a lessee of state lands[16] may assert estoppel against the Board. Although the Court refused to estop the Board on the facts of that case, there was no suggestion that the Board was entitled to special deference or that it leased public lands in a governmental capacity. Indeed, Justice Maughan, dissenting from the majority opinion and

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16 It cannot be determined from the opinion whether school trust lands were involved in Morgan, but there is no rational basis for distinguishing these lands from state lands in general. The State is required to hold all public lands in trust for the benefit of the public. Utah Const. art XX, § 1.

concluding that the facts supported estoppel, was consistent with the majority in stating: "Here the State acts to dispose of public lands, by lease. It thus acts in its proprietary capacity and equitable estoppel is a proper remedy." Id. at 700 (Maughan, J., dissenting); accord State v. Horr, 165 Minn. 1, 205 N.W. 444, 445 (1925) (state receives lands in sovereign capacity to hold in trust for school fund, but state acts in proprietary capacity when selling timber from such lands and is subject to estoppel); Youngstown Mines Corp. v. Prout, 266 Minn. 450, 124 N.W.2d 328, 344-45 (1963) (state acts in proprietary capacity when it leases state land even when, by statute, proceeds from those lands must be deposited in permanent school fund); Durell v. Miles, 53 N.M. 264, 206 P.2d 547, 550 (1949) (state acts in proprietary capacity when leasing state lands and is subject to estoppel); see also Arizona Title Guarantee & Trust Co. v. State, 60 Ariz. 555, 142 P.2d 212, 213 (1943) (distinguishing lands acquired by state under Arizona Enabling Act, which are held in proprietary capacity, from lands acquired by state in tax foreclosure, which are held in governmental capacity); Greene v. Esquibel, 58 N.M. 429, 272 P.2d 330, 336-41 (1954) (same conclusion under New Mexico Enabling Act).

The State cites Duchesne County v. State Tax Comm'n, 104 Utah 365, 140 P.2d 335 (Utah 1943), for the proposition that it acts in a governmental capacity when leasing school trust lands. In Duchesne County, the county argued that lands acquired by the state through foreclosure of mortgages taken by the state to secure loans from the State School Fund were subject to taxation. The Court reasoned that the state held title to revenues derived from state lands in its governmental capacity,[17] and was therefore exempt from taxation by the county. Duchesne County dealt with the state's amenability to taxation by a local governmental entity; it did not deal with the state's capacity in the leasing of public lands to private entities. In Morgan, however, the Court has indicated the State acts in a proprietary capacity in the latter situation. The leasing of state lands to private entities to obtain a profit for the State, far from being the paradigm of a governmental function that the State asserts it to be, is clearly a proprietary or business activity.

3. The Elements of Equitable Estoppel are Established Under the Undisputed Facts of this Case.

In Morgan, the Court set forth the elements of estoppel:

> Estoppel arises when a party . . . by his acts, representations, or admissions, or by his silence when he ought to speak, intentionally or through culpable negligence, induces another . . . to believe certain facts to exist and that such other . . . acting with reasonable prudence and diligence, relies and acts thereon so that he

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17 Indeed, the Court made a sweeping statement to the effect that the state always acts in a governmental capacity. 140 P.2d at 343. This theory has not been followed in subsequent cases. On the contrary, the Court has explicitly recognized that the state acts in both governmental and proprietary capacities. See, e.g., Celebrity Club, 602 P.2d at 694.

> will suffer an injustice if the former . . . is permitted to deny the existence of such facts.

549 P.2d at 697; see also Celebrity Club, Inc. v. Utah Liquor Control Comm'n, 602 P.2d 689, 694 (Utah 1979).

(a) Inducement. Plateau and its predecessors (collectively "Plateau"), mined coal under the State Lease on a regular basis for nearly twenty years, through December of 1984. At all times during this period, including the Audit Period, Plateau paid a royalty of $0.15 per ton of coal mined under the State Lease. This rate was clearly reflected in the coal production and settlement transmittals submitted by Plateau and its predecessors to the State each quarter. The State reviewed and accepted the royalty payments and the coal production and settlement transmittals each quarter without objection.

In May 1980, James T. Jensen, attorney for Plateau, telephoned Donald G. Prince, the Assistant Director of the Division, to inquire whether the State Lease was in good standing. The Division responded with a letter dated May 19, 1980 from Mr. Prince representing that the State Lease was in good standing, but for the failure to pay 1980 rentals (R. 147, 369-70, 500). Understandably, the letter makes no reference to deficient royalty payments, since the Division had not yet adopted the 8% theory.

Cyprus purchased Plateau in August, 1985 (R. 148). In an attempt to assure itself of Plateau's ownership of the State

Lease and to identify any outstanding liabilities associated with the State Lease, Cyprus, prior to consummating the purchase, conducted a review of both Plateau's records and the State Lease file maintained by the Division (R. 148). The purpose of this examination was in part to ascertain whether the State Lease was in good standing and whether all rentals and royalties due under the lease had been properly paid (R. 148). Neither the State Lease file nor Plateau's own records contained any indication that the Division believed that past royalty payments were deficient in any respect (R. 148, 370, 500). On May 16, 1985, Division personnel orally assured John Stewart, a land man hired by Cyprus to conduct a records search, that the State Lease was in good standing and that all rental and royalty payments had been properly made (R. 148). With these assurances, Cyprus consummated the purchase of Plateau on August 30, 1985, unaware of the State's position that the State Lease was not in good standing and that over $3,000,000 in past royalties, interest and penalties were due (R. 148-49, 370, 500). The State failed to inform Cyprus of the results of the royalty audit even though it was aware of the alleged royalty underpayment by March 6, 1985 and had completed the royalty audit by May 29, 1985 (R. 149-50, 370-71, 501). The Division deliberately withheld this information from Plateau and Cyprus until October 15, 1985 (R. 150, 371, 501).

The State's only response to these undisputed facts is (1) a muted claim that the representations of good standing made by the Assistant Director of the Division and other Division employees did not mean that royalties were paid in full, and (2) an assertion that silence will not support an estoppel. See Appellants' Brief at 35.

The State's first argument smacks of post hoc rationalization. The State had no definition of good standing, nor did it have any policies regarding determinations of good standing (R. 497). Moreover, regardless of how the State now defines a representation of good standing, Plateau justifiably construed it to be a representation that there was no outstanding deficiency in royalty payments and no question as to the manner in which Plateau was calculating and paying royalties.

As to the State's second point, it is clear under Utah law that silence when a party ought to speak will support an estoppel. See Morgan, 549 P.2d at 697. The essence of the State's claim is that it had no duty to do or say anything with regard to the royalty provision. This argument is untenable. The State drafted the prevailing federal rate clause and included it in the State Lease for its own benefit. The record shows that the State has long known that the clause is ambiguous. See supra pp. 15-17. Because the clause is ambiguous on its face, the State could not legitimately have expected Plateau to apply it without some agreement as to its meaning. The District Court properly rejected the theory that the prevailing federal rate clause was self-executing (R. 677). <u>See</u> <u>supra</u> pp. 23-27. In other words, the State was obligated to affirmatively act to invoke the clause.

The State also argues that it had no duty to speak because it has "thousands" of mineral leases and therefore cannot be expected to determine if its lessees are in compliance with the terms of the lease. Appellants' Brief at 6. While the State may have many mineral leases, there were only six coal leases that were actually producing during the Audit Period, and the royalty provisions in these leases were similar (R. 153, 497).[18] No audit was necessary for the State to determine how its six producing coal lessees were calculating royalties. The production reports and settlement transmittals clearly showed the lessees were paying at a cents per ton rate, rather than a percentage of value. Even if, as the State claims, it did not have enough employees to check each of these leases every time payment was made, this does not justify its failure to raise any question concerning the manner in which its lessees were interpreting the leases, particularly when the State knew at the time it was receiving payments that the prevailing federal rate clause was ambiguous.

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18 Five lessees were audited. The sixth was not because it went bankrupt prior to the audit (R. 452).

A case in which a private party lessor was estopped from demanding higher royalty payments on an oil and gas lease than were paid by the lessee supports Plateau's position that the State should be estopped under these facts. La Fitte Co. v. United Fuel Gas Co., 177 F. Supp. 52 (E.D. Ky. 1959), aff'd, 284 F.2d 845 (6th Cir. 1960), involved an ambiguous royalty provision which provided that the royalty was one-eighth of the gross income received by lessee but did not specify either the place of market or the price to be paid. Over the course of the lease, the lessee made royalty payments based on the wholesale market price at the wellhead. The lessor accepted the payments, with full knowledge of the basis for payment, without objection. The lessor brought an action for underpayment of royalties. The court dismissed the complaint and held that the lessor was estopped from demanding higher royalty payments:

> By retention of the royalty checks and accounting statements by the plaintiff and its predecessors, without any objection whatever, for the long period of years (1924 to 1952), and all of the accompanying circumstances discussed by the court, the defenses of equitable estoppel and laches are sustained. Where the lessee renders to the lessor monthly accounts and makes payments based thereon which the lessor receives and keeps without objection, such accounts are conclusive on the lessor, in the absence of full and satisfactory evidence of fraud or mistake.

177 F. Supp. at 68. Likewise, the State is estopped from demanding payment of royalties on coal mined during the Audit Period at any rate higher than $0.15 per ton.

The State clearly had a duty to speak in a timely manner if it believed the prevailing federal rate clause was applicable. The State's silence alone would support estoppel in this case. When that silence is combined with the State's acceptance of royalty payments for nearly twenty years and its representations of good standing, the first element of estoppel is unquestionably established.

(b) Reasonable Reliance. Plateau relied on the State's acts, representations and silence in continuing to mine coal under the State Lease (R. 150-51). Moreover, given the ambiguities of the prevailing federal rate clause, given the State's actions and statements indicating that $0.15 per ton was the applicable royalty rate, and given the lack of any reason to act to the contrary, Plateau did what any prudent and diligent lessee would do: it paid royalties at the $0.15 per ton rate.[19]

The State invokes a recurring but specious assumption in arguing that Plateau's reliance on the State's actions and silence was unreasonable: that the "prevailing federal rate" for

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19 As did the four other state coal lessees during the Audit Period (except for Consolidation Coal Company, which had an agreement with the State to pay at the rate of $.0175 per ton) (R. 156, 373, 503).

"lands of similar character" was somehow self-evident and easily discernible. For example, the State contends that Plateau was not entitled to rely on "erroneous" statements of a government employee (apparently referring to the representations of good standing), as if such an "error" should have been obvious to Plateau. Appellants' Brief at 34. Another example of this theme is the State's assertion that estoppel will not operate in favor of one who has a convenient and available means of obtaining knowledge of the "actual" facts. Id. However, the most stunning example of the State's misdirected assumption is its contention that the State relied on Plateau to "accurately report and accurately pay the correct royalty amount," and therefore that Plateau, and not the State, should be estopped. These arguments simply ignore the fact that the prevailing federal rate clause is ambiguous and is not susceptible to a single "accurate" and "correct" interpretation. The fact that Plateau had federal coal leases with a royalty of 8% did not make it apparent to Plateau that 8% was the "correct" royalty rate under the State Lease. Under the State's theory, Plateau could never be sure that it was paying the "correct" royalty because any interpretation of the "prevailing federal rate" made by Plateau could later be challenged by the State as erroneous.

In addition, Cyprus relied on the State's representations of good standing and its failure to notify Cyprus of any deficiency when Cyprus purchased Plateau in 1985. The

State has argued that Cyprus' reliance was unreasonable because Cyprus was aware that the State had conducted a field audit of Plateau in early 1985, but did not inquire as to the status of the audit (R. 370). However, Plateau was regularly audited by governmental entities. A field audit was not an event which would cause Cyprus or Plateau to be concerned that royalty payments had been deficient (R. 500), especially when Cyprus conducted a search of the State Lease file and was told by the Division that the lease was in good standing.

Plateau and Cyprus simply had no reason to question the State's acts, representations and silence, given the ambiguity of the prevailing federal rate clause and the parties' long-standing course of performance. Thus, their reliance was reasonable and, as pointed out below, will result in great injury of the State if not estopped.

(c) Injury. Plateau was under no obligation to mine coal under the State Lease. Had the State asserted its present position at any time during the Audit Period, Plateau would have ceased mining the coal subject to the State Lease and would have pursued other options, including mining other coal subject to a royalty rate lower than 8% (R. 150-51). Had the State asserted its present position early in 1985 when Cyprus was contemplating the purchase of Plateau, Cyprus could have pursued other avenues that are now foreclosed, such as either not purchasing Plateau or purchasing it on different economic terms (R. 150).

If the State is allowed to repudiate its actions and statements that the royalty rate is $0.15 per ton and is allowed to exact its claimed royalty at the rate of 8%, and collect interest and penalties, Plateau will be injured in the amount of approximately $3,000,000, plus additional interest. If Plateau is required to pay this amount to the State, it will have mined the State Lease at a substantial loss, because mining the coal subject to the State Lease during the Audit Period at an 8% royalty rate would result in a negative cash flow of $1.70 on every single ton of coal mined during that period, and that figure does not include costs for capital replacements. This would mean a negative cash flow over the Audit Period of $1,810,408.20 (R. 150-51, 371, 501). In light of these facts, the State's assertion that "paying what is owed under the lease is not an injury," Appellants' Brief at 34, not only begs the question of what was "owed," it is patently ridiculous.

The State asserts that it disputed the facts demonstrating injury to Plateau by attaching Exhibits 7 to 10 to its Motion for Summary Judgment. Appellants' Brief at 35. Exhibits 7 and 8 (R. 416, 419) are internal Plateau memoranda that the State obtained through discovery. In its motion, the State asserted, without further elaboration, that these documents show that the royalty rate was not a consideration in choosing to mine the State Lease (R. 317). However, these documents, if at all probative, reflect that the royalty was a consideration in mining the State Lease and further that the royalty rate of $0.15 per ton was the only positive factor in favor of mining the State Lease. (See, e.g., R. 422.) Exhibit 9 (R. 424-25) is a newspaper clipping that the State asserted shows the profit Plateau was making on all its mining operations (R. 371). Such irrelevant and hearsay evidence does not create an issue of fact in the face of the affidavits submitted by Plateau showing that the mining of coal under the State Lease was barely profitable (R. 211-15, 265-67). Exhibit 10 (R. 426-30) is a monthly report which the State asserted shows that mining the State Lease at 8% would have been profitable (R. 371-72). As Plateau pointed out, however, Exhibit 10 (and also Exhibit 11), summarize information for Plateau's entire mining operations during the periods stated in the reports, which included mining under other leases (R. 501-02). They do not reflect that mining coal under the State Lease at 8% would have been profitable. The trial court properly found that the State's exhibits failed to raise an issue of fact and agreed that Plateau would show a substantial loss on all mining activity under the State Lease if the State is allowed to retroactively impose an 8% royalty (R. 679).

A private party would be estopped in this case, and because the State acted in a proprietary capacity, it should be treated no differently than a private lessor. However, should the Court find that the State acted in a governmental capacity, the two additional requirements for estopping the State, manifest injustice to Plateau and lack of a substantial adverse effect on public policy, are also present in this case.

4. <u>Manifest Injustice to Plateau Will Result if the State is Not Estopped</u>.

Had the State timely informed Plateau that it believed 8% to be the applicable royalty rate, the State Lease would not have been mined because it would have been unprofitable to do so, and the State would have received no royalty (R. 150-51). Accordingly, the Division's current assertion that 8% was the appropriate royalty rate, if successful, can only result in a windfall to the State. The State would receive an 8% royalty from a leasehold that, because of poor quality of reserves or other reasons, does not justify such a rate and would never have been mined at that rate. And it will receive that windfall at the expense of Plateau, which mined the coal reasonably believing that the appropriate rate was $0.15 per ton and anticipating that under such a rate it would receive a reasonable return for its efforts. If the State is successful in its current assertion, monies earned by Plateau from mining the State Lease, and then some, will be shifted to the State's coffers in the form of a windfall. An 8% royalty rate would increase Plateau's royalty obligation twelve to thirteen-fold. Such a result would clearly be unjust.

5. Estopping the State Will Not Impair the State's Ability to Manage School Trust Lands, Nor Will Denying the State a Windfall at Plateau's Expense Have a Substantial Adverse Impact on Public Policy.

The core of the State's argument is that the Utah Enabling Act and the Utah Constitution somehow require that the State receive 8% of value under the State Lease. Specifically, the State has argued that it cannot be estopped, no matter how egregious its conduct or the injury to Plateau, because the school fund would be denied additional revenue for coal mined by Plateau during the Audit Period. However, a rule absolutely proscribing the application of estoppel when adverse impacts on the school trust fund might result would be unprecedented and would be contrary to this Court's view as expressed in Celebrity Club, Sutro & Co. and Morgan. Moreover, the absolute bar to estoppel sought by the State would not be limited to coal leases on school trust lands. What the State seeks is nothing less than a rule which would give it free reign to repudiate any and all past contractual obligations and agency regulations concerning the disposition of state lands whenever it concludes after the fact that it did not get the best bargain it could have. Such a rule offends all notions of fairness and should be rejected.

The State's "trust" argument, if relevant at all when the State acted in a proprietary capacity, should be considered within the analytical framework of Celebrity Club and Sutro & Co. In other words, the only issue is whether denying the school fund additional revenues for coal mined during the Audit Period in any way impairs the State's ability to manage school lands or amounts to a substantial adverse effect on public policy.

(a) Estopping the State will not impair its ability to manage school trust lands. Estopping the State in this case will prevent it from retroactively asserting its recently formed interpretation of the prevailing federal rate clause, and nothing more. The State incorrectly asserts that a ruling against it would result in "an ongoing loss of more than $2.00 per ton for coal produced after the audit." Appellants' Brief at 18. This is clearly impossible because Plateau discontinued mining the State Lease before the end of the Audit Period (R. 146). As the District Court noted, "the State can still proceed to lease coal lands on any terms it feels profitable and that will give the State the maximum return. They still have the power to revise the wording of their coal leases to do away with any ambiguity and to carry out any legally established policy" (R. 679).

(b) Estopping the State Will Not Have a Substantial Adverse Effect on Public Policy. Two of this Court's decisions, when read together, indicate what does not constitute a substantial adverse effect on public policy. In First Equity Corp. v. Utah State Univ., 544 P.2d 887 (Utah 1975), a stock broker brought an action against Utah State University ("USU") to recover commissions and other losses incurred because USU refused to accept and pay for shares of stock which a USU officer ordered. The court held the contract between USU and the broker was void, not because it was expressly prohibited, but because there was nothing in Utah law that expressly or impliedly permitted a state university to invest in common stock. The court therefore held that because the contract was ultra vires and void, the stock broker could not recover. Id. at 893.

Utah State Univ. v. Sutro & Co., 646 P.2d 715 (Utah 1982), involved the flip-side of the dispute in First Equity. This time, USU brought an action against several stock brokers to recover losses sustained by USU as a result of its investment program, the same program that had been previously held unauthorized and therefore null and void in First Equity. The stock brokers argued that USU was estopped from attempting to recover these losses. This Court held that the stock brokers were entitled to present facts in support of their estoppel claim at the trial level, even though USU was acting as a trustee in managing state funds. Id. at 717, 720-21. The Court reasoned that there are two types of contracts or activities on the part of the state: (1) those that are "malum in se, or which are strictly prohibited by statute, and thus may be strongly against public policy," and (2) those such as the contracts with the brokers that were not authorized by law but which were not "inherently evil." Id. at 719. The court stated:

> In the former class of cases, it is quite universally held that no estoppel will lie

> against the government, whereas in activities which are merely ultra vires the courts are more likely to allow such a defense; and this is also true of situations when the governmental entity engages in proprietary or business activities.

Id. Thus, even though the contracts were void and unenforceable and contrary to public policy, and resulted in substantial losses of school funds, the brokers were entitled to assert estoppel against USU when it sought to recover its losses under the contracts. In light of First Equity and Sutro & Co., denying the State the windfall it seeks here cannot be considered a substantial adverse effect on public policy, even when the effect might be to deny the school fund some unspecified sum of money.[20]

The State argues that its acceptance of $0.15 per ton during the Audit Period was contrary to the Utah Enabling Act and Constitution. See Appellants' Brief at 30. However, nothing in either of these enactments strictly prohibited the State from accepting $0.15 per ton. Kadish v. Arizona State Land Dept., 155 Ariz. 484, 747 P.2d 1183 (1987), upon which the State relies for the proposition that a flat $0.15 per ton rate would be

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20 The State's assertion that the school trust fund would lose over three million dollars is based on several incorrect assumptions. This amount includes the interest and penalty assessed against Plateau. As noted infra at pages 66-69, the District Court concluded as a matter of law that the State was not entitled to those sums. Moreover, the State assumes that 8% was the federal rate prevailing on lands of similar character. However, the District Court's ruling made it unnecessary to determine the prevailing federal rate during the Audit Period.

"impermissible" and "unconstitutional," Appellants' Brief at 17, 23, is not applicable here. Kadish interpreted the Arizona-New Mexico Enabling Act and the Arizona Constitution, which specifically provide that no minerals and other products of school trust lands may be sold for less than their "appraised . . . true value." 747 P.2d at 1186. The court held a statute providing for a flat 5% royalty on minerals was unconstitutional under these provisions. Id. at 1196.

Unlike the Arizona-New Mexico Enabling Act and the Arizona Constitution, the Utah Enabling Act and Constitution do not expressly and have never been interpreted to impose any substantive or procedural restrictions on the manner in which the State disposes of trust lands. The only restriction is found in section 10 of the Utah Enabling Act and article X, section 3 of the Utah Constitution, which require that proceeds from lands received under the Enabling Act be used to support the public schools. These laws left it to the Utah Legislature to prescribe procedures and requirements for the disposal of school lands. See Utah Const. art. XX, § 1 (school lands to be disposed of as may be provided by law). The legislature in turn left it to the Board and Division of State Lands to establish royalty rates. See Utah Code Ann. § 65-1-18 (1986) (repealed by Trust Land Management Act, 1988 Utah Laws ch. 121, effective July 1, 1988). There is no support for the contention that the State's acceptance of $0.15 per ton is "strictly prohibited" by law.

The State argues that the Utah Enabling Act and Constitution implicitly limit the State's authority in establishing royalty rates, i.e., that the State did not have the authority to accept less than "fair market value," in disposing of minerals from school lands. See Appellants' Brief at 28-29. The cases cited by the State for the proposition that the Utah Enabling Act and Constitution require the receipt of "full" or "fair market value" involved state agency actions or state statutes that were deemed inconsistent with various other enabling acts and state constitutions. See Appellants' Brief at 12-16. As noted above, Kadish involved a statute that was found contrary to particular provisions in the Arizona Constitution and Enabling Act. As Plateau has pointed out, however, the Utah Enabling Act and Constitution do not include any provisions related to the manner of disposing of state lands or the value that must be obtained therefrom. Nor have these provisions been interpreted to impose a general duty to obtain "full" or "fair market" value, however those terms may be defined.

Moreover, this Court need not decide whether these laws impose such a duty on the State, because even assuming that they do, and assuming the State breached such a duty in this case,[21]

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21 As discussed further below, even if the State had a duty to obtain fair market value, however that may be defined, there has been no showing that such a duty has been breached in this case. An issue of fact exists as to the fair market value of coal mined under the State Lease during the audit period. See infra p. 53.

the State is still estopped. Any adverse impact on public policy in this case would be of no different nature or degree than that in Sutro & Co. Both cases involved actions of state officials, acting as trustees, that resulted in losses of comparable magnitude to various school funds. Moreover, in this case if the State had asserted an 8% royalty during the Audit Period, Plateau would not have mined coal under the State Lease and the State would have received no royalty. Allowing the State to repudiate its past actions and to obtain such a windfall is strongly against public policy; estopping the State is not.

The cases cited by the State do not establish that estopping the State here would have a substantial adverse effect on public policy. In State ex rel Comm'rs of Land Office v. Phillips Petroleum, 258 P.2d 1193 (Okla. 1953), the court refused to estop the state after it had, through a clerical error, conveyed a mineral interest along with the surface estate in certain school trust lands. In Phillips Petroleum, the equities were clearly not in favor of the party asserting estoppel: an examination of the Notice of Sale for the land, which clearly reserved the mineral interest, or the rules and regulations governing the sale would have revealed the error. Id. at 1199-1200. The court also noted that the actions of the state agency in this case, i.e., the giving away of the mineral interest were "clearly" beyond the authority of that agency. Id. at 1200.

Phillips is thus distinguishable factually and in terms of the law it applied. It is clear under Sutro & Co. that unauthorized acts alone do not bar the application of estoppel against the State. On the contrary, Utah law calls for a balancing test in this situation. If the facts of Phillips were before this Court, it might well find under this balancing approach that the State should not be estopped. But in this case, the balance is in favor of Plateau: the elements of estoppel are satisfied; the injury to Plateau is manifest; there was nothing about the State's conduct that was "clearly" beyond its authority. Moreover, the State's actions, even under its "breach of trust duty" theory, were not so strictly and clearly prohibited by law as to be strongly against public policy. Phillips does not, as asserted by the State, support a rule against applying estoppel to the State simply because school trust lands are involved.

The same is true of State v. Northwest Magnesite Co., 28 Wash. 2d 1, 182 P.2d 643 (1947). In Northwest Magnesite, a mineral lease provided for a royalty of 4% of the receipts from the sale of minerals after deducting costs of treatment and transportation. This method of calculating royalties was explicitly required by statute. However, the lessee and the commissioner of state lands agreed that royalties should be paid based on 4% of receipts after deducting mining costs as well as treatment and transportation costs, in direct contravention of the lease and the statute. The court stated three bases for its refusal to estop the state from recovering royalties as provided in the lease rather than the agreement: the commissioner's promise was contrary to an express legislative enactment; the commissioner did not have authority to enter into the agreement; and the lessee did not present sufficient evidence to establish the elements of estoppel, and particularly did not show that estopping the state was necessary to prevent manifest injustice. Id. at 656-58. Far from establishing a per se rule against estopping the state because of its "trust duty," the Northwest Magnesite court closely examined the facts of the case and decided that estoppel was simply not justified.[22] Northwest Magnesite, therefore, does not support the State's argument.

In Department of State Lands v. Pettibone, 702 P.2d 948 (Mont. 1985), the issue was whether the lessee of school land acquired ownership of water diverted or developed on the land. Id. at 952. The court held that, because water rights acquired become appurtenant to land, they became the property of the State and not the lessee. Because the leases did not include payment for the water right, the court would not imply a sale of the

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22 Among the key facts the court relied on were the following: the agreement was clearly and directly in contravention of the lease and a state statute; the evidence showed that the lessee did not rely on the agreement; and there was no evidence that the lessee was injured. Id. at 657-58. As Plateau has shown in this case, the State's actions were not clearly contrary to the State Lease or any statutes; Plateau justifiably relied on the State's actions; and Plateau will suffer clear injury if the State is not estopped.

water to the lessee. Id. at 955. A secondary issue was whether the state should be estopped from asserting an interest in the water. The court noted that, because of the trust doctrine, the state had no power to grant the lessees the right to develop non-appurtenant water rights; it also noted that the lessees had not detrimentally relied on any actions by the state. Id. at 956-57. Thus, Pettibone, like the other cases on which the State relies, did not involve a strict rule against applying estoppel where school trust lands are involved, but rather was based on considerations specific to the facts at hand. These cases are not dispositive of the present case, in which a balancing test must be applied to the specific facts.

In sum, this Court should not depart from prior Utah case law by holding that estoppel can never be applied when the school land trust would be denied additional revenue. Rather, the Court should hold that denying the State the windfall it seeks in this case is not a substantial adverse impact on public policy. The Court should also hold that the undisputed facts of this case support estoppel against the State, and that the injustice to Plateau if the State is allowed to assert its 8% theory retroactively is readily apparent. In short, the Court should uphold the District Court's finding that the State is estopped from retroactively invoking the prevailing federal rate clause.

Finally, if this Court finds that the State had a duty to obtain fair market value for coal mined under the State Lease during the Audit Period, and if this Court finds that the State's failure to obtain fair market value is an adverse impact on public policy sufficient to outweigh the injustice to Plateau of allowing the State to retroactively assert its interpretation of the prevailing federal rate clause, the Court must remand this case for a determination as to whether the State in fact breached its alleged duty. Contrary to the State's assertions, the "fair market value" of coal mined from the State Lease during the Audit Period has not been determined. Plateau certainly has not conceded, and the trial court did not conclude, that the "fair market value" of coal mined during the Audit Period was 8% or any other amount greater than $0.15 per ton. The trial court implicitly found that, even if the fair market value of the coal mined from the State Lease was something greater than $0.15 per ton, the State should be estopped from asserting a deficiency. Therefore, if the Court disagrees with the District Court, this case must be remanded for a determination as to whether the State in fact received less than fair market value.

E. The District Court Properly Found that the State May Not Retroactively Apply Its New Policy Imposing a Royalty Rate of 8%.

Under the State's newly formed interpretation of the State Lease, the royalty provision is self-executing, and no individual consideration of leases to determine whether 8% was the prevailing rate for "lands of a similar character" is necessary. The State need not consider whether any federal leases were actually issued at the 8% rate or, of those that were issued, whether any of them covered lands of a character similar to lands covered by the state leases. In addition, the State need not consider the effect of existing federal leases with royalty rates of less than 8%.[23]

Prior to its October 1985 demand for additional royalties, the State had pursued a different course; it accepted royalties at the $0.15 per ton rate from all but one of its lessees, with no suggestion that the higher 8% rate should apply. In one instance, the State reached a prior agreement with its lessee, Consolidation Coal Company ("Consol"), that a royalty rate of $0.175 per ton should apply (R. 156, 373, 503). This agreement, reached in 1981, was based upon an individual assessment of the federal prevailing rate for lands of a character similar to that covered by Consol's lease. In reaching this agreement, the State relied upon an existing federal lease with a royalty rate of $0.175 per ton; the Division made no reference to FCLAA or the 8% rate it now contends was applicable during that time period (R. 156, 293, 373, 503). The State's treatment of

23 The State's interpretation is also nonsensical. See infra p. 73.

Consol and other lessees establishes that from 1976 to 1985, this type of prior agreement and determination was the procedure the State believed was applicable under the royalty provisions. In Plateau's case, the State affirmatively stated the lease was in good standing on two occasions, even though royalties had always been paid at the $0.15 per ton rate. The State's treatment of these leases as being in good standing despite the payment of the lower royalty rate reflects its policy that the $0.15 per ton rate was the applicable royalty rate until there was a determination or agreement to the contrary. This policy was confirmed by the State's comments to one of its lessees that such a rate would continue until changed by action of the parties. See supra p. 25.

The State's attempt to apply its new policy retroactively to the Audit Period cannot be allowed. The public has the right to expect that an agency will adhere to its policies until new policies are announced, and that when prior policies have been relied upon, new policies will not be applied retroactively to the detriment of the relying parties. This fundamental principle was applied in Continental Oil Co. v. United States, 184 F.2d 802 (9th Cir. 1950), where the court readily concluded that a new royalty policy such as that involved here could not be applied retroactively. In that case, the United States Department of the Interior adopted a new policy affecting oil and gas lease royalty calculations that conflicted with its prior policy.

It attempted to apply the new policy retroactively to all royalty payments that were outstanding because of a separate dispute between the Department and its lessees. The court summarily dismissed the Department's contention that such a policy could be applied retroactively:

> As for the government's claim that the Secretary might recompute the gas royalties owing where lessees had not paid the bills previously rendered, in other words, make his June 7, 1937 order retroactive, we think the [trial] court correctly construed the provision of the lease permitting the Secretary to fix the value of gas for royalty purposes as operating prospectively only. Statutes are always so construed. We think that a contract provision as extraordinary as is this authorization to fix values, should no less be interpreted as having prospective operation only.

Id. at 821 (citation omitted). The State is in no different a position than the federal government was in Continental Oil. It cannot, after a long-standing practice of accepting $0.15 per ton as the applicable royalty rate under the state leases, change that policy retroactively to the detriment of its lessees.

In determining whether an agency may apply a new policy retroactively, the courts consider whether the retroactivity is reasonable under the circumstances. That reasonableness is analyzed under a balancing test, which weighs the "ill effect of the retroactive application" against the "mischief of producing a result which is contrary to a statutory design or to legal and equitable principles" if the policy is not retroactively applied.

Securities Exchange Comm'n v. Chenery Corp., 332 U.S. 194, 203 (1947).

The court in Retail, Wholesale & Department Store Union v. NLRB, 466 F.2d 380 (D.C. Cir. 1972), expanded on the Chenery balancing test by enumerating specific factors to consider under a retroactivity analysis. This five-part analysis, which has been adopted by a number of courts, requires consideration of:

1. Whether the particular case is one of first impression;

2. Whether the new rule represents an abrupt departure from well established practice or merely attempts to fill a void in an unsettled area of law;

3. The extent to which the party against whom the new rule is applied relied on the former rule;

4. The degree of burden which a retroactive order imposes on a party; and

5. The statutory interest in applying the new rule despite the reliance of a party on the old standard.

Id. at 390.

The first two factors set forth in Retail Union, whether the case is of "first" or "second impression" and whether the new rule departs from established practice or merely attempts to fill a void in an unsettled area of law, have similar purposes. Both factors are used to measure the reasonableness of a party's reliance on the prior state of the law, did the relying party have notice of the pending change in policy. See, e.g., at 390-91 and n.22.

The State Lease was issued with a Board approved royalty rate of $0.15 per ton. Until October of 1985, the State's statements and actions confirmed that this would be the applicable royalty rate under the lease until that rate was changed by a contrary determination or agreement between the parties. The State never deviated from this policy until October of 1985. Because this long-standing practice gave the State's lessees no notice of its subsequent change in policy, the lessees were entitled to rely upon the former practice and their reliance certainly was reasonable.

At an early date, the United States Supreme Court established that parties may rely on a long-standing agency practice and that such practices are to be given the effect of law and "considered binding on past transactions." United States v. McDaniel, 32 U.S. (7 Pet.) 1 (1833). In McDaniel, the Court determined that the practice of paying additional money to an agency employee for the performance of duties outside of his regular employment was an established "usage." Although there was no authority for this additional payment, the government was not allowed to retroactively recover for the compensation paid to the employee. "[O]f necessity, usages have been established in every department of the government, which have become a kind of common law, and regulate the rights and duties of those who act within their respective limits. And no change of such usages can have a respective [sic] effect, but must be limited to the future." Id. at 15.

This recognition that an agency's long-standing practice is binding on the agency and that parties may rely on such a practice has continued to the present day. For example, in Stewart Capital Corp. v. Andrus, 701 F.2d 846, 848 (10th Cir. 1983), the court ruled that the Bureau of Land Management's practice of accepting oil and gas lease drawing cards filed with stamped, facsimile signatures, without requiring that they be accompanied by separate statements of the agent and offeror, was binding on the agency for previously filed cards. The agency's practice in accepting such cards for a six year period precluded the Agency from rejecting, under a newly adopted policy, cards that complied with the agency's prior practices.

Where an agency's long-standing practice reflects an interpretation of an ambiguous statute, regulation or other provision, the agency will be held to its prior interpretation. This is so because an individual faced with an ambiguous law or rule has only one reasonable alternative, to follow the interpretation adopted by the agency charged with the responsibility of administering the rule or law. For example, in McDonald v. Watt, 653 F.2d 1035 (5th Cir. 1981), another oil and gas lease offer case, the court concluded that where the agency's regulation was ambiguous, the plaintiff's reliance on the agency's prior practice interpreting that regulation was reasonable, and the agency could not retroactively apply a new policy to invalidate lease drawing cards that complied with the prior practice. 653 F.2d at 1044-45. As discussed supra at pages 10-17, the royalty provision of the State Lease is ambiguous. Faced with the inherent ambiguities of the prevailing federal rate clause and the uncertainty regarding how that clause would be effectuated, Plateau's reliance on the agency's long-standing practice of accepting $0.15 per ton as the applicable royalty rate under the lease must be viewed as a reasonable response to these uncertainties.

The next two factors to be considered under the Retail Union balancing test, the extent of a party's reliance on the prior rule and the degree of burden which the retroactive order imposes on the party, are similar to the detrimental reliance aspect of the estoppel doctrine discussed supra at pages 37-39. As discussed in that section, both Plateau and Cyprus relied on the State's prior policy, and if the State is now allowed to alter that policy retroactively, they will be unfairly penalized for that reliance. As one court has observed:

> [An agency] decision branding as "unfair" conduct stamped "fair" at the time a party acted, raises judicial hackles . . . . And the hackles bristle still more when a financial penalty is assessed for action that might well have been avoided if the agency's changed disposition had been earlier made known . . . .

NLRB v. Majestic Weaving Co., 355 F.2d 854, 860 (2d Cir. 1966) (citations omitted). Here, the financial penalties imposed on

Plateau and Cyprus, i.e., the operating losses associated with the newly imposed 8% rate and the loss associated with the purchase of Plateau could have been avoided had the State made its newly promulgated policy known earlier.

Under the last factor of the Retail Union balancing test, the State must establish a statutory interest that "compels" the retroactive application of the the new rule. Retail Union, 466 F.2d at 392. The only statutory interest involved here is the State's interest in receiving a return from its coal resources leased to Plateau with no fraud or duress in the leasing transaction. Again, the State is in no better position under Utah law in this commercial setting than is any other contracting party. In this case, the State's interest has been satisfied over the years with Plateau's payment and the State's receipt of royalties under the State Lease. If the Division is allowed to impose retroactively an 8% royalty rate on coal mined during the Audit Period, the State will receive more than it contracted for in leasing its resources; it will receive a windfall that it would not have enjoyed had the Division's present position been made known earlier. Because there is no statutory interest in, or authority for, the State claiming a windfall at the expense of its lessee, the State's attempt to apply its new royalty policy retroactively should not be condoned by the Court.

F. The District Court Properly Found that the State's New Royalty Policy is a Rule which is Invalid Because of the State's Failure to Follow the Provisions of the Utah Administrative Rulemaking Act.

Under the provisions of the 1985 Utah Administrative Rulemaking Act, which was in effect when the State announced its new royalty policy, Utah agencies that adopt new rules must follow the procedures specified in that Act. Utah Code Ann. § 63-46a-3 (1986). The Act defined a rule as

> a statement made by an agency that applies to a general class of persons, rather than specific persons and: (i) implements or interprets policy made by statute; or (ii) prescribes the policy of the agency in the absence of express statutory policy. . . .

Id. § 63-46a-2 (8)(a) (current version, as amended in 1987 and 1988 provides that rule "applies to a class of persons or an agency"). The State's new royalty policy requiring an 8% royalty rate under all of the leases having royalty provisions similar to that contained in the State Lease is a rule within the meaning of this statute. Therefore, it cannot be adopted either prospectively or retrospectively without compliance with the rulemaking procedures of the statute.

In Williams v. Public Service Comm'n, 720 P.2d 773 (Utah 1986), the Utah Supreme Court applied the provisions of an earlier version of the Rulemaking Act to a Public Service Commission decision that it had no jurisdiction to regulate one-way mobile telephone paging services. In that case, the Commission had since at least 1962 purported to regulate one-way paging services by issuing certificates of public convenience and necessity to at least four applicants and denying requests for certificates of authority to others. However, in 1983, the Commission reversed itself and announced, without engaging in a rulemaking proceeding, that it had no jurisdiction to regulate one-way paging services.

In considering the validity of that ruling, the Williams Court acknowledged that in some circumstances an agency may announce new policy in informal adjudications, but observed that this procedure is not allowed where the agency is fundamentally altering a prior policy that had been relied upon by affected parties. The Court concluded that when a policy makes a "change in clear law" the agency is engaged in rulemaking and ruled that:

> Under all these circumstances, we conclude that the Commission cannot reverse its long-settled position regarding the scope of its jurisdiction and announce a fundamental policy change without following the requirements of the Utah Administrative Rule Making Act.

Id. at 776-77. In reaching this conclusion, the Court reasoned that because the new policy of the Commission affected the four holders of certificates authorizing one-way paging services, it was a statement of "general applicability" and therefore a rule within the meaning of the Rulemaking Act in effect at the time the Commission issued its ruling. Id. at 776. The definition of "rule" was revised in 1985; at the time Williams was decided, the statute provided that a rule is a statement that applies to a "general class of persons rather than specific persons"; however, the Court observed that its conclusion would not be different were it to analyze the matter under the latter statute. Id. at 775 n.7.

Under the rationale of the Williams case, the State's new royalty policy announced in October of 1985 was a rule, which, absent compliance with the procedures of the Rulemaking Act, is invalid and may not be applied prospectively, much less retrospectively. As with the policy considered in the Williams case, the royalty policy, which affects all lessees having leases containing the royalty provision at issue here, affects a "class of persons." The policy prescribes the policy of the agency and it represents a clear departure from the prior practice of the agency. Under these circumstances, the State should not be allowed to enforce its policy, either prospectively or retrospectively, until it complies with the Rulemaking Act.

G. The State Waived Whatever Right It Had to Demand Payment of Royalties on Coal Mined During the Audit Period at Any Rate Higher than $0.15 Per Ton.

The Utah Supreme Court has defined waiver as "the intentional relinquishment of a known right. To constitute a waiver, there must be an existing right, benefit or advantage, a knowledge of its existence, and an intention to relinquish it.

It must be distinctly made, although it may be expressed or implied." American Savings & Loan Assoc. v. Blomquist, 21 Utah 2d 289, 445 P.2d 1,3 (1968) (quoting Phoenix Ins. Co. v. Heath, 90 Utah 187, 61 P.2d 308 (1936)). The Court has distinguished between the doctrines of estoppel and waiver as follows:

> The doctrine of estoppel is a different principle than, and must be distinguished from, the legal doctrine of waiver. As noted above, waiver is the voluntary, intentional relinquishment of a known right. Estoppel, on the other hand, is a doctrine which precludes parties from asserting their rights where their actions or conduct render it inequitable to allow them to assert those rights.

Hunter v. Hunter, 669 P.2d 430, 432 (Utah 1983).

Crestview Bowl, Inc. v. Womer Construction Co., Inc., 225 Kan. 335, 592 P.2d 74 (1979), involved the interpretation of a provision of a lease which required monthly rental payments plus any increase in taxes. At no time prior to the dispute did the landlord request payment of tax increases, and the landlord accepted base rental payments without a request for additional payments for tax increases. Further, the landlord accepted the tenant's exercise of an option to extend the lease, a condition precedent to the option being that the "terms and conditions of this lease are fully and faithfully performed." Based on the tenant's payments and the landlord's failure to object to the amount of the payments or the tenant's exercise of the option to extend, the Supreme Court of Kansas held that the landlord waived its right to tax increase payments. Id. at 80.

Similarly, Plateau submitted to the State royalty payments and coal production and settlement transmittals that clearly reflected that payments were made at the rate of $0.15 per ton. Prior to 1985, the State did not object to the amount or to the rate of royalty payments. Further, as discussed supra at page 24, the State indicated that it would take no action to increase the $0.15 per ton rate until the lease was up for readjustment. Thus, the Division voluntarily relinquished, and consequently waived, its right to demand royalty payments at a rate higher than $0.15 per ton.

H. The District Court Properly Found that the State May Not Apply its Interest and Penalty Rules to the State Lease.

In the event that this case is remanded and it is found that Plateau owes the State any additional royalties, it must be determined what, if any, penalties and interest are owed. The Court should therefore rule on the following issues only if it remands the case for a determination of the "prevailing federal rate."

1. Pursuant to the Express Terms of the State Lease, the State May Not Impose the Terms of the November, 1982 Interest Rule on Any Royalty Payment Deficiencies Should Such Deficiencies be Found to Exist.

The State has demanded accrued interest on the allegedly past-due royalties in the amount of $1,058,542.32. This amount represents interest at the statutory rate of 6% for the period from January, 1979 through June, 1981; at the statutory rate of 10% for the period from July, 1981 through November, 1982 and at the regulatory rate of 18%, based upon a rule adopted by the Board on November 4, 1982, for the period from December, 1982 through October, 1985.

Article I of the State Lease provides: "This lease is granted subject in all respects to and under the conditions of . . . existing rules and regulations and such operating rules and regulations as may be hereafter approved and adopted by the State Land Board" (emphasis added). Section 65-1-96 of the Utah Code provides that all mineral leases issued by the Board prior to 1967 shall be subject to the conditions and provisions contained in the leases. Thus, the State Lease is only subject to rules and regulations existing as of March 15, 1965 (the date of the State Lease) and "operating" rules and regulations adopted thereafter by the Board.

The Board had no rule or regulation regarding interest when the State Lease was issued. Thus, there is no regulation regarding interest which can be applied to this lease. Furthermore, the Board's 1982 interest rule cannot be applied to this lease, because it cannot be characterized as an "operating" rule. The Utah Supreme Court holds that all words must, if possible, be given their usual and ordinary meaning. Commercial Building Corp. v. Blair, 565 P.2d 776, 778 (Utah 1977). There is no reason not to give the word "operating" its ordinary meaning in the context of this state minerals lease. The usual and ordinary meaning of "operating" is "engaged in some form of operation." Webster's Third New International Dictionary (1971).

The Board's 1982 interest rule is not a rule that governs the lessee's actions or operations on the land. If the interest rule is an "operating" rule or regulation, it is difficult to envision which of the Board's rules or regulation are "non-operating" and why the Board chose to make a distinction between operating and non-operating rules and regulations in drafting the State Lease. The authority to impose new "operating" rules and regulations on lessees provides the Board with the opportunity to regulate mining activities on leased lands that might adversely affect the state's mineral reserves, the public health and safety or the environment. The 1982 interest rule clearly does not fall within the ambit of this retention of authority. Thus, it cannot be applied to any royalty deficiencies which may be due under the State Lease.

2. Defendants Are Not Entitled to Interest on Any Alleged Royalty Payment Deficiencies for Periods of Time Prior to Defendants' First Demand for Payment of the Alleged Deficiencies.

No interest charge, whether based on statute or regulation, may accrue in this case until a demand is made for the principal. This rule was adopted by the Utah Supreme Court in Staker v. Huntington Cleveland Irrigation Co., 664 P.2d 1188, 1191 (Utah 1983), which involved a claim for overpayments made by mistake to an irrigation company. The Court ruled that the prejudgment interest award should only run from the date that the plaintiff demanded the return of the overpayment and not from the date that the overpayment was made. Accordingly, since the Division did not make a demand for alleged royalty underpayments until October 15, 1985, it has no right to interest, if any, until after the date of the demand.

3. Pursuant to the Express Terms of the State Lease, Defendants May Not Impose the Terms of the December, 1983 Penalty Rule for Any Royalty Payment Deficiencies that this Court May Find to Exist.

The State has demanded payment of a 6% penalty based on a rule adopted by the Board in December, 1983. The argument set forth above with respect to the Board's November 4, 1982 interest rule is also applicable to the penalty rule: the Board had no penalty rule when the State Lease was issued and the Board's 1983 penalty regulation cannot be characterized as an "operating" rule. Since the State Lease was granted subject only to existing regulations and such operating regulations as may be adopted by the Board, the 1983 penalty rule is not applicable to the State Lease.

III. THE DISTRICT COURT PROPERLY DENIED THE STATE'S MOTION FOR PARTIAL SUMMARY JUDGMENT.

The District Court denied the State's Motion for Partial Summary Judgment (R. 680), wherein the State requested the court to find as a matter of law that 8% of gross sales value was the applicable royalty under the prevailing federal rate clause of the State Lease during the Audit Period (R. 355). The District Court's decision was proper because the Record shows there were facts in dispute necessary to the State's motion. Furthermore, the State failed to assert necessary facts in support of its Motion, including support for its assertion that the prevailing federal royalty rate was 8%.

A. Plateau Raised Specific Issues Showing That There Are Genuine Issues For Trial.

Rule 56(c) of the Utah Rules of Civil Procedure provides in part:

> The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

Foremost among the State's material facts which Plateau controverted is the following: The State asserted that the "federal royalty rate on leases issued since 1979 in Utah has been the same regardless of location, quality of coal, etc" (R. 361). The State's own authority controverts this assertion and shows that such royalty rates ranged from 5% to 12.5% (R. 496).

Furthermore, the State's assertion assumes that a change in the royalty rate pursuant to the prevailing federal rate clause is to be based only on newly issued leases. This interpretation does not comport with a plain reading of the clause which instead indicates that the rate is to be based on federal coal leases in effect at the beginning of the quarter. See infra, pp. 72-73. The royalty rates for federal coal leases in effect during the Audit Period ranged from $0.10 per ton to 12.5% of value in Utah and across the nation.

B. The State Failed To Assert Facts In Support Of Its Motion For Partial Summary Judgment.

Among the facts which the State failed to assert in support of its Motion for Partial Summary Judgment are the following:

1. Facts establishing that the leases referred to in Exhibit 1 to the Affidavit of Robert Lopez (attached as an exhibit to Defendants' Summary Judgment Memorandum) (R. 468) are for "land of similar character" or are otherwise relevant to the prevailing federal rate clause.

2. Facts establishing that 8% was the "prevailing rate" for "coal leases issued by the United States."

3. Facts establishing that 8% was the prevailing rate for federal coal leases for land of a similar character in effect at the beginning of each quarter of the Audit Period.

In sum, because Plateau raised genuine issues of material fact and because the State did not establish facts supporting its Motion for Partial Summary Judgment, the District Court properly denied the State's Motion for Partial Summary Judgment.

C. It Cannot Be Said That The Prevailing Federal Royalty Rate During The Audit Period Was 8%.

The State argues that the meaning of the royalty provision is clear and that the prevailing federal rate clause requires payment of royalties at the rate of the majority of the federal coal leases newly issued during the Audit Period.[24] According to the State, under FCLAA and the regulations promulgated thereunder, the prevailing rate for all underground federal coal leases after 1976 was 8% of the coal value. See supra p. 5 n.4. The State claims that the majority of such leases were issued at the royalty rate of 8%, and that therefore the royalty rate payable under the royalty provision was 8%.

Contrary to the State's position, the wording of the prevailing federal rate clause does not indicate that it refers

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24 See Affidavit of Ralph Aiello, ¶ 5 (R. 451), wherein Mr. Aiello, an auditor for the State, states, "[a]fter reviewing Article III of the state coal lease regarding royalty rate [sic], I started gathering information to determine that royalty rate was required to be paid by the lessees since the leases required payment of 15 cents per ton or the rate charged for federal leases issued in the quarter the royalty was due on lands of similar character, whichever was higher" (emphasis added).

only to newly issued leases, and the State offers no authority for such an interpretation. In addition, the clause does not refer to leases issued <u>during</u> the quarter but rather to leases issued "at the <u>beginning</u> of the quarter," which could mean that it refers to all leases issued before the beginning of the quarter. Consideration of all federal leases that were in effect during the reporting quarter would certainly comport with a plain reading of the clause and would result in a practical application of the clause.

The State's interpretation that the clause refers only to newly issued leases issued in Utah during the reporting period is also nonsensical. Application of this interpretation would result in a royalty rate payable under the lease of $0.15 for some reporting quarters when no new federal leases were issued, but 8% for other quarters when federal leases were issued. Specifically, as set forth in Appendix XVI to Plateau's Reply Memorandum (R. 597), Plateau was in production during 22 of the 23 quarters during the Audit Period. There were newly issued leases during only 10 out of 22 producing quarters. Thus, application of the State's interpretation of the royalty provision would result in a royalty rate of 8% for 10 quarters and $0.15 per ton for 12 quarters.

The State has not submitted facts showing that 8% was the prevailing rate for federal coal leases of land of similar character in effect during the Audit Period. The underground royalty rates for such leases varied between $0.10 per ton and 12.5% of value (R. 496). A trial would be necessary to determine the prevailing rate for coal leases of land of similar character during the Audit Period.

CONCLUSION

When the State Lease was issued in 1965, it was issued at the fixed royalty rate of $0.15 per ton. Plateau paid, and the State received, royalty payments at the rate of $0.15 per ton on coal mined under the State Lease from 1965 through 1984. The Division did not object to the amount of royalty payments or the royalty rate until 1985. The State represented to Plateau in 1980 that the State Lease was in good standing. Plateau relied on these representations and the State's failure to object to royalty payments in choosing to mine coal under the State Lease. In 1985, after Plateau had discontinued mining the State Lease, Cyprus questioned the State as to whether there were any outstanding liabilities associated with the State Lease. The State indicated that the lease was in good standing, and failed to inform Cyprus of the audit report findings. Cyprus relied on the State's representations and silence in acquiring Plateau. The State is now deviating from its twenty-year course of performance and is attempting to impose retroactively a novel interpretation of the State Lease which would injure Plateau in the amount of approximately $3,000,000.00.

Coal subject to the State Lease was of marginal quality and mining it was barely profitable under the rate actually paid. Mining the coal would not have been economic at a royalty rate higher than $0.15 per ton. Had the State demanded a higher rate at any time during the Audit Period, Plateau would have ceased mining under the State Lease, and thereafter the State would have received no royalties whatsoever. To give the State increased royalties would result in an unconscionable windfall to the State.

This case is a textbook example of circumstances supporting estoppel against the State. The undisputed facts clearly support a holding that the State is estopped from demanding any royalty payment other than the $0.15 per ton that it has already been paid. Any other ruling by the Court would result in a serious injustice to Plateau. The State's trust argument is overshadowed by this injustice and the fact that the school land trust would be poorer today if the State had asserted an 8% royalty during the Audit Period because Plateau would not have mined the State Lease.

The findings and the judgment of the District Court are supported by the Record and should thus be upheld by the Court. If the Court finds that a royalty other than $0.15 was required to be paid by Plateau during the Audit Period, this case should be remanded to the District Court for factual findings on the royalty rate.

DATED this 17th day of August, 1988.

JAMES M. ~~ELEGANTE~~
PATRICIA J. WINMILL
LUCY B. JENKINS
KENNETH R. BARRETT
of and for
PARSONS, BEHLE & LATIMER
Attorneys for Plaintiffs
185 South State Street, Suite 700
P.O. Box 11898
Salt Lake City, UT 84147-0898
Telephone: (801) 532-1234

MAILING CERTIFICATE

I hereby certify that I caused to be mailed, postage prepaid, a true and correct copy of the foregoing BRIEF OF RESPONDENTS to the following on this 17th day of August, 1988:

David L. Wilkinson
David S. Christensen
124 State Capitol
Salt Lake City, Utah 84114

Gayle F. McKeachnie
Clark B. Allred
NIELSEN & SENIOR
363 East Main Street
Vernal, Utah 84078

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APPENDIX A

FACTUAL ASSERTIONS OF THE STATE UNSUPPORTED BY THE RECORD

1. Appellants' Brief at 4: "The Director, after a hearing, upheld the audit and the demand for payment." The State's citation to page 436 of the record does not support this assertion.

2. Appellants' Brief at 4: "The United States Government owns most of the coal-producing lands within the State of Utah."

3. Appellants' Brief at 5: "When State Lease no. 22729 was issued by the State, the royalty rate on many federal coal leases was $.15 per ton."

4. Appellants' Brief at 5: "The federal coal lease royalty rate generally remained at $.15 per ton until August 4, 1976."

5. Appellants' Brief at 6: "Instead the State of Utah, as written in its lease provisions and regulations, requires its lessees to accurately provide information and to pay the correct amounts of royalties."

6. Appellants' Brief at 7: "Plaintiffs, upon receipt of the audit report, requested a hearing before the Director of the Division of State Lands. A hearing was held."

7. Appellants' Brief at 16: "The market royalty rate on coal leases, in the state of Utah, is controlled by the United States which has the vast majority of coal reserves. Lessees require long-term leases because of the capital expenditures involved."

8. Appellants' Brief at 17: "The State therefore, drafted an escalator clause in its coal lease which tied the royalty revision to the prevailing federal rate. That escalator clause insured that the State would, throughout the term of the lease, receive full market value."

9. Appellants' Brief at 18: " . . . with an ongoing loss of more than $2.00 per ton for coal produced after the audit."

10. Appellants' Brief at 19: "A reading of the royalty provision in the lease (Article III Second) shows that it is clear and complies with the intent of the parties that the trust lands receive the going royalty rate. It states that the royalty rate will be $.15 per ton (which was the federal rate when the lease was signed). . ."

11. Appellants' Brief at 20: "Plaintiffs have the duty to determine any change in the federal royalty rate."

12. Appellants' Brief at 20: "The federal government owns the majority of coal reserves in Utah."

13. Appellants' Brief at 21: "The Plaintiffs . . . concede that the federal rate is higher than the royalty payment they paid prior to 1976."

14. Appellants' Brief at 23: "The Federal Government owns the majority of coal reserves in the State of Utah and therefore the royalty rate charged by the Federal Government constitutes the prevailing market rate in the State of Utah. At the time the lease provision was drafted the federal royalty rate was generally $.15 per ton."

15. Appellants' Brief at 23: "The escalator clause was required by law and the obvious intent of the parties, when the contract was entered into, was to provide a mechanism whereby the State would always receive the going market royalty rate from its trust lands."

16. Appellants' Brief at 24: "One of the things that is certain about the royalty provision, in addition to the plain meaning of Subsection b, is that the contracting parties intended that the royalty rate would change if federal royalty rates increased."

17. Appellants' Brief at 25: "Their silence concedes that the rate is something higher than $.15."

18. Appellants' Brief at 25: In this particular case the undisputed facts establish that the prevailing federal rate is 8% of value. Any changes in the rate can be easily determined by review of Bureau of Land Management records."

19. Appellants' Brief at 34: "Indeed, the undisputed facts show that it was the State that relied on the Plaintiffs to pay the correct royalty amount. The Plaintiffs had the duty to the State to calculate and pay the correct royalty. The State did not have a duty to Plaintiffs to collect the correct royalty although it has such a duty to the school trust."

20. Appellants' Brief at 6: "The lands that the Division of State Lands manages have thousands of mineral leases."

21. Appellants' Brief at 6: "Like reporting taxes, it has largely been an honor reporting system."

22. Appellants' Brief at 9: "The State has a . . . moral duty to obtain full value from the disposition of those lands."

APPENDIX B

DIFFERENT INTERPRETATIONS OF THE STATE LEASE ROYALTY PROVISION

Royalty Provision **Language:**

To pay to Lessor quarterly, on or before the 15th day of the month succeeding each quarter, royalty

(a) at the rate of 15¢ per ton of 2000 lbs. of coal produced for the leased premises and sold or otherwise disposed of, or

(b) at the rate prevailing, at the beginning of the quarter for which payment is being made, for federal lessees of land of similar character under coal leases issued by the United States at that time,

whichever is higher . . .

Ambiguous Phrase	Different Interpretations
"at the rate prevailing"	1. the rate of the majority of leases 2. an average of rates 3. the highest rate
"federal lessees of land . . . . under coal leases"	1. all federal coal leases in the nation 2. federal coal leases in the West 3. federal coal leases in Utah 4. federal coal leases in the same region 5. federal coal leases in the same county 6. federal coal leases in the same drainage area 7. federal coal leases in the same mine 8. producing federal coal leases 9. non-producing federal coal leases

"land of similar character"	Land with: 1. similar geological or physical characteristics 2. similar access characteristics 3. similar degree of development completed 4. coal with similar fuel utilization potential 5. similar environmental or regulatory restrictions 6. similar labor force availability
"coal leases issued by the United States at that time"	1. all federal coal leases in effect on the date of the beginning of the reporting quarter 2. all federal coal leases in effect during the reporting quarter 3. all federal coal leases in effect during the Audit Period 4. federal coal leases newly issued on the date of the beginning of the reporting quarter 5. federal coal leases newly issued during the reporting quarter 6. federal coal leases newly issued during the Audit Period

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